

Resolution of Københavns Andelskasse, insights and observations from a DGS perspective

EFDI EU Committee

Berlin, 14 March 2018

Troels Bay Simonsen

Finansiel Stabilitet



Finansiel **Stabilitet**

Agenda

- **Finansiel Stabilitet**
- **Resolution scheme for smaller Danish banks**
- **Københavns Andelskasse (Copenhagen Cooperative Bank) – resolution and DGS issues**

Finansiel Stabilitet - Financial Stability Company

- Financial Stability Company (FS) is owned by the Danish State through the Ministry of Industry, Business and Financial Affairs
- Established in 2008 as a result of the financial crisis with the objective to wind up weak financial institutions taken over as part of the pre-BRRD national resolution regime
- When appointed resolution authority and DGS in June 2015, FS was transferred from a limited company to an independent public entity (IPE) and the assets and liabilities of the DGS were transferred to FS

Finansiel Stabilitet - resolutions

Bank Package I:

- EBH Bank (November 2008)
- Løkken Sparekasse (March 2009)
- Gudme Raaschou Bank (April 2009)
- Fionia Bank (May 2009)
- Roskilde Bank (August 2009)
- Capinordic Bank (February 2010)
- Eik Bank (October 2010)
- Eik Banki (October 2010)

Bank Package III:

- Amagerbanken (February 2011)
- Fjordbank Mors (June 2011)

Bank Package IV:

- Max Bank (October 2011)
- Sparekassen Østjylland (April 2012)

Bank Package V:

- FS Property Finance (March 2012)

BRRD:

- Andelskassen J.A.K. Slagelse (October 2015)
- Københavns Andelskasse (September 2018)

Costs paid by capital owners, subordinated debt and banking sector via insurance regime with back stop

Costs paid by capital owners, subordinated debt and bail-in of senior creditors including not-covered deposits and DGS (hair cuts approx. 15 %)

Costs paid by capital owners, subordinated debt and dowry from FSC and DGS

Solvent liquidation

Costs paid by capital owners, subordinated debt and full bail-in of senior creditors including not-covered deposits and DGS



Current legal framework

- The legislation implementing BRRD entered into force as of 1 June 2015
- Two resolution authorities
 - The powers dedicated in BRRD to the resolution authority are divided between the Financial Supervisory Authority (FSA) and Finansiel Stabilitet (FS)
- The FSA is the acting resolution authority until the institution meets the conditions for resolution
- FS is the acting resolution authority when the resolution conditions are met
- FS is the Danish DGS

Agenda

- **Finansiel Stabilitet**
- **Resolution scheme for smaller Danish banks**
- **Københavns Andelskasse (Copenhagen Cooperative Bank) – resolution and DGS issues**

Preferred resolution strategy for smaller Danish banks

- When the resolution conditions are met FS initiates resolution.
- FS takes control and replaces the management.
- All losses are absorbed through write down of relevant capital instruments and if necessary bail-in, incl. DGS.
- Ownership is transferred to a bridge institution (holding).
- The bridge holding is owned and capitalized by the resolution fund, and the bridge holding will, if required, temporarily recapitalize (no loss absorption) the failing institution.
- A sales process is initiated immediately. Preferably it is carried out during the weekend but more realistically in the following few weeks/month.
- Parts not sold are wound up in a controlled manner by FS.

State aid approved scheme (Banks with assets of maximum 3 billion EUR)

Preferred resolution strategy for smaller Danish banks

Public interest test DK

- In Denmark, payment cards (Dankort), electronic payments and payments through internet banks are widely used.



- In addition, public authorities, insurance companies etc. will transfer means to citizens via electronic payments to their primary bank account (NemKonto)

- Further, credit facilities (lines) are commonly used both for businesses (big as well as small) and households. There is no protection (DGS or similar) ensuring that access to these will be restored within a short timeframe.

- When the use of cash is decreasing, up to 7 days without access to deposits will create disturbance.



- In previous resolution schemes (pre-BRRD) it was a high priority to ensure customers access to mentioned accounts and services etc. on an uninterrupted basis in case of a failing institution. This approach has been continued.

- Individual assessment.



Agenda

- **Finansiel Stabilitet**
- **Resolution scheme for smaller Danish banks**
- **Københavns Andelskasse (Copenhagen Cooperative Bank) – resolution and DGS issues**

Københavns Andelskasse

Facts

- Cooperative bank with office in Copenhagen – no branches
- At resolution time, Københavns Andelskasse had a balance sheet total of approx. EUR 50 million.
- Total deposits approx. EUR 41 million.
- Many foreign depositors, including e-money and payment institutions.
- Over the past years, the Danish FSA has issued substantial orders to Københavns Andelskasse.



Orders from the Danish FSA (over the past years)

- Risk management
 - Inconclusive reporting in regards to main risk areas
 - Lacking general overview of the risks associated with the business model of Københavns Andelskasse
- Data quality challenges
- Poor administrative set-up
- Governance
 - The management's insufficient knowledge regarding financial regulation
 - The management's insufficient knowledge regarding Københavns Andelskasse itself
 - Board members' conflicts of interests and non-observance of board members' lack of competence to act in legal matters
 - Several orders regarding fitness and propriety ("fit and proper")
- Repeated violations of AML-provisions and financial regulation



The Danish FSA's inspections in June-August 2018

The Danish FSA carried out **two inspections** of Københavns Andelskasse in June-August of 2018

- Unsound business model
- Lacking risk management
- Issues regarding governance – insufficient knowledge of financial regulation
- Continued breach of confidentiality
- Issues regarding AML



The Danish FSA notified the police of the violations of AML-provisions.

Failing or Likely to Fail – Decision of 13 September 2018

FSA Decision of 13 September 2018

The Danish FSA found basis for revoking
Københavns Andelskasse's license

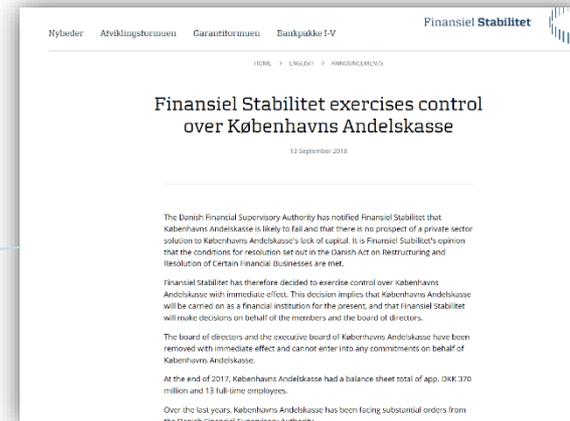


The Danish FSA assessed that
Københavns Andelskasse was **likely to fail**



On 13 September 2018 (20:00 CET)
FS took control over Københavns
Andelskasse

*"The Danish FSA found that Københavns Andelskasse was in violation of financial regulation in all of the areas subject to the inspection. The Danish FSA found that Københavns Andelskasse in many instances failed to observe regulation, that the Danish FSA also on previous inspections had found Københavns Andelskasse to be in violation of.
The Danish FSA found upon the inspection that Københavns Andelskasse was not capable of correctly determining its capital base, capital adequacy nor liquidity. A correct determination of all three items is crucial for properly operating a bank."*



Resolution of Københavns Andelskasse

Based on the assessment that the conditions for resolution were met

- FS decided to exercise control over Københavns Andelskasse with immediate effect.
- The board of directors and the executive board of Københavns Andelskasse were removed with immediate effect. FS appointed new members of the board of directors and a new executive manager of Københavns Andelskasse. The entire management team was already employed by FS.
- FS established a new subsidiary, Broinstitut II A/S (bridge institution), which took ownership (holding) of Københavns Andelskasse under kontrol.



Resolution of Københavns Andelskasse

Applied resolution measures

- FS has performed a provisional valuation (valuation 2) of Københavns Andelskasse for the purpose of identifying and determining the extent of the losses.
- The provisional valuation 2 showed a need for further loss absorption
 - Uncertainty in regards to creditor hierarchy due to not yet completed overview of covered deposits
 - Members, subordinated creditors, ordinary unsecured creditors and depositors with deposits not covered by the Danish DGS were informed that claims had been provisionally written down entirely and lost (write down of capital instruments and bail-in).
- Transactions made after Thursday, 13 September 2018 at 20:00 CET, when FS assumed control of Københavns Andelskasse, were carried out in the context of "Københavns Andelskasse under kontrol" (subject to FS' control).
- Københavns Andelskasse was able to provide services to its customers from Friday morning (the next day).



Resolution of Københavns Andelskasse

Further resolution measures

- FS is in the process of initiating a final valuation of Københavns Andelskasse. The final valuation will be carried out by an independent valuation accountant.
- Once the final valuation is available, FS will reassess the provisional write-downs.
- The activities of Københavns Andelskasse will according to the preferred strategy be wound up in a controlled manner:
 - Termination with immediate effect of relations with non-resident business customers (with reference to its standard terms).
 - Review of the loan portfolio for identification of potential portfolios to be sold
 - Process initiated regarding obtaining AML identification from customers.



Bail-in ↔ Covered deposits

As covered deposits are not subject to bail-in, FS has in a number of cases had to assess whether or not deposits in Københavns Andelskasse are covered by the DGS.

Known case types (handled in accordance with FS's practise)

- Joint accounts
- Public authorities
- THB

**SECOND DECISION BY FINANSIEL STABILITET
ON THE RESOLUTION OF KØBENHAVNS ANDELSKASSE UNDER KONTROL
DATED 13 SEPTEMBER 2018**

1. BACKGROUND

1.1 On 13 September 2018, Finansielt Stabilitet made the first decision ("**First Decision**") on resolution of Københavns Andelskasse under kontrol, CVR no. 82112219, Gammeltorv 4, 2., 1457 Copenhagen K, Denmark (the "**Institution**") under the Danish Act on Restructuring and Resolution of Certain Financial Businesses (the "**Act**"), in which connection Finansielt Stabilitet decided to exercise control over the Institution and replace the executive board and the board of directors. Reference is made to the First Decision for a description of the background for carrying out the resolution of the Institution.

2. ADDITIONAL CONSIDERATIONS

2.1 In addition to the considerations listed in the First Decision, Finansielt Stabilitet has considered the following:

- a) that the provisional valuation of the assets and liabilities of the Institution prepared by Finansielt Stabilitet in accordance with Section 7 of the Act implies that it is necessary to cancel the contributed capital, to write down relevant capital instruments and to carry out bail-in for loss absorption of all subordinated obligations and certain obligations that are not subordinated;
- b) that the ownership of the Institution will be transferred to Broinstitut II A/S (the "**Bridge Institution**"), which is a bridge institution owned by Afviklingsformuen ved Finansielt Stabilitet pursuant to Section 21 of the Act², and that this will enable Finansielt Stabilitet to carry on the operation of the Institution for the purpose of implementing a controlled resolution, including to sell parts of the Institution if relevant; and
- c) that amendments to certain contracts to which the Institution is a party may be necessary in order to imple-

Financial institutions

FS has had to make an assessment of whether or not a number of companies are **financial institutions** (CRR definition), eg. payment service providers and electronic money institutions.

Lack of information in Københavns Andelskasse, so the assessment is based on available public information.

FS has had to ask the depositor for information or documentation of

- the company's business and/or working area (e.g. an annual report)
- the company's employees
- whether or not the company is working with financial services
- whether the company has a license from a financial conduct authority
- company registrations

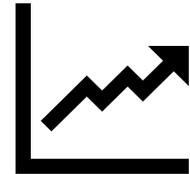


❖ **Operators of crypto currency trading platforms**

FS has had to assess, whether crypto currency trading platforms are included in the definition of financial institutions.

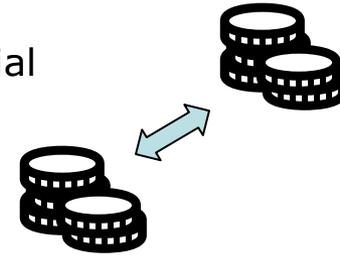
The following has been determined:

- Crypto currency is – as a main rule – not a financial instrument
- Crypto currency trading platforms are – as a main rule – not financial institutions
- However – specific assessment of each platform, as the business of a trading platform is easily connected with other activity relating to financial institutions, e.g. specifics regarding set-up of platform accounts



Financial institutions

FS has had to assess, whether the following are financial institutions:



❖ **Exchange bureaus**

The following has been determined:

- Exchanging currency requires a license from the Danish FSA, but the bureau is not a financial institution (unless due to other activity)
- Exchanging currency is not on its own a payment service

❖ **Agents for payment institutions**

The following has been determined

- Specific assessment
- Agents are not per se financial institutions, seeing as they act on behalf of a payment institution

Segregated accounts / client funds

A number of payment services etc. claimed they had segregated accounts or held client funds in Københavns Andelskasse

Assessment of whether or not someone other than the depositor is *absolutely entitled* to funds.

In most cases this information is not available in Københavns Andelskasse.

FS has asked the depositor for the following:

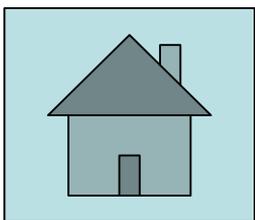


- documentation evidencing that the account has been treated as a client account, incl. segregation of funds
- documentation of absolute entitlement, incl. the identity of each entitled person as well as the amount to which he/she is entitled

FS has asked for documents to be certified by an external lawyer and auditor's statements from an authorised external, independent auditor.



Examples



Example # 1 – no activity

Company A is newly established as a financial institution with the purpose of investing in companies dealing with payment services etc.

However, Company A has not yet carried out any activity.

Is the deposit of Company A a covered deposit exempt from bail-in?

Preliminary assessment: Company A was set up as a financial institution and is only able to function as such and for this reason excluded from coverage. The lack of activity does not affect this.

Examples

Example # 2 – operating without a license

Company B carries out payment services, but without a license from the Danish FSA.



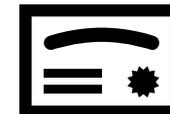
Payment services are not a main activity of Company B. For this reason, Company B claims it is not a financial institution.



Obtaining a license may require limiting other activities.



Preliminary assessment: FS regards Company B as a financial institution excluded from coverage, unless it can be documented that Company B could obtain a license to carry out payment services with the same level of activity.



Examples



Example # 3

Company C manages a website on behalf of Company D, including collecting subscription fees. The subscription fees collected in Company C's account are in part used for paying the management fee to Company C, in part used for paying bills on behalf of Company D, and the rest seems to remain in Company C's account.

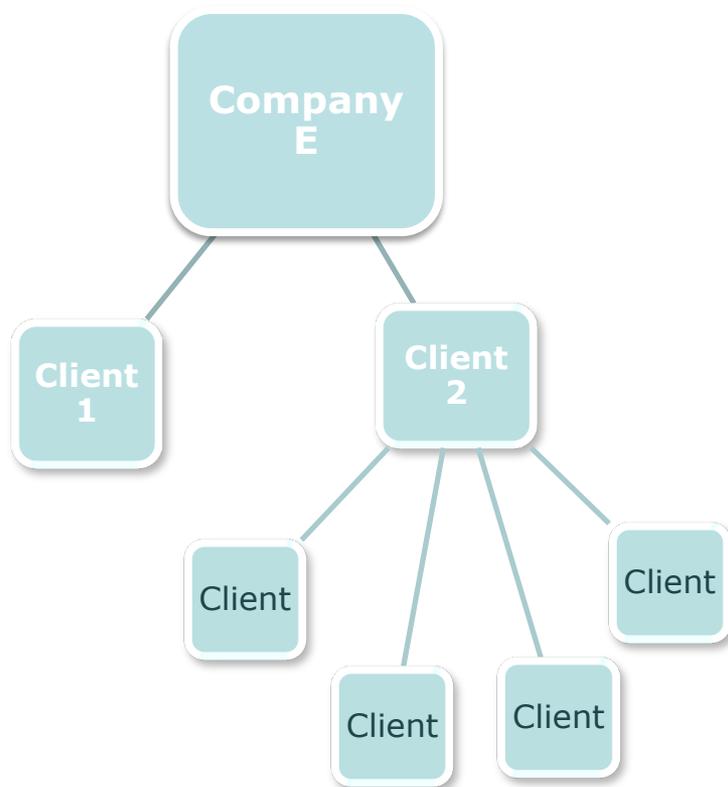
Is Company C a commercial agent and as such excluded from the definition of a financial institution?

Also, if both Company C and Company D are entitled to funds in the account, how is this entitlement sufficiently documented?

Status: FS has asked the company to provide more information in order to make an assessment regarding the commercial agent exclusion.

In regards to the question of absolute entitlement FS has asked for documentation verified by an external, independent auditor.

Examples



Example # 4 – a customer’s customers

Company E is a financial institution.

Company E’s account is registered as a segregated account.

According to Company E, its deposit consists of third party funds belonging to Client 1 and Client 2.

Status: FS maintains that Client 2 is the absolutely entitled – as stated in the auditor’s statement – until documentation stating otherwise is provided.

Observations – resolution and DGS perspective



Practical challenges and issues from a post-perspective

- Data quality and IT-systems within the failing bank are crucial for the valuation and calculation of bail-in and determination of DGS coverage.
- Work is not finalised subsequent to the takeover process – the smaller a bank the more work proportionally.



- Necessary to deploy FS staff to Københavns Andelskasse.
- DGS issues in relation to coverage of segregated accounts.



- Communication is crucial
 - towards the public, the bank's employees, customers and creditors
 - towards relevant entities (the European Commission, EBA, the European Supervisory Authority, national authorities etc.)

Observations (cont.)

- In practice Denmark has been operating a bail-in regime since 2010 and several banks have been taken over under this set-up
- Synergies between DGS obligations and resolution – payouts are in general managed via existing clearing systems
- Agile set-up with different skills available both in-house and externally
- Develop multiple solution set-ups in order to remain flexible in case preferred strategy fails
- And as always when it concerns resolution and DGS – **expect the unexpected**

Questions?

